

APPENDIX "A"

As discussed in the "Reply and Motion of Illinois-American Water Company," Illinois-American has accepted Staff's proposal to correct the "Cash from Operations to Interest" and "Cash from Operations to Total Debt" Ratios to reflect additional cash resulting from decreased income taxes. These corrections are shown on Late-Filed Exhibit 1 (Revised).

Contrary to the arguments of Staff, however, there are no other "errors" which require correction. Staff first asserts (Resp., p. 2) that the Late-Filed Exhibits are in "error" because they do not reflect the recent rate increase authorized in Docket 00-0340 or a future rate case for the CUCI area. These comments, however, show a misunderstanding of the purpose of the Exhibits. IAWC Exhibit 2.1R and follow-up Staff Schedule 10.1 were intended to show the effect on Illinois-American's pre-acquisition financial ratios of the acquisition of CUCI, with no savings sharing or other form of recovery of the Acquisition Revenue Requirement. To accomplish this, IAWC selected a representative base year, 1999, in which, as shown on Staff Schedule 10.1, IAWC realized a 10.09% rate of return on common equity on a stand-alone basis and the combined properties realized a 10.9% return on common equity. No rate relief was sought or required for 1999. The purpose of Late-Filed Exhibit 1 is to show the effect of the Acquisition on the pre-acquisition data, and Late-Filed Exhibit 1 does this correctly.

It is true that, in years after 1999, operating costs and rate base increased, and a rate filing was required for IAWC to maintain a reasonable rate of return. The rate order in Docket 00-0340 allows a 10.2% rate of return on common equity, which is below the level for the combined company in 1999, but somewhat above Illinois-American's stand-alone rate of return of 10.09% for that year (Staff Sch. 10.1). The reflection of the rate order data in place of IAWC's stand-alone data on Late-Filed Exhibit 1 would slightly increase the three ratios shown (due to

the small change in rate of return from 10.09% to 10.2%). Not every year, however, is a rate case test year. IAWC believes that the base year selected for Late-Filed Exhibit 1 is reasonably representative of IAWC's pre-acquisition "actual" financial condition and that adjustment of the Exhibit to reflect hypothetical conditions during the test years of the two referenced rate cases would be unnecessary and inappropriate.

Staff (Resp., pp. 2-3) next criticizes IAWC's calculation of Savings. As shown on Late-Filed Exhibit 1, however, Mr. Stafford has utilized 50% of the amount of Savings calculated for Year 1 as shown on IAWC Exhibit 3.1R. Staff's next assertion (Resp., p. 3) that the Late-Filed Exhibit does not identify Phase I and Phase II is nonsense. As the headings of Column 7 and Footnote 10 indicate, Phase I on Late-Filed Exhibit 1 is an annual period during which 50% of Savings are shared as recommended in the Proposed Order. As indicated in the heading of Column 9 and in Footnote 1, Phase II on Late-Filed Exhibit 1 is an annual period subsequent to the Order in a rate case filed more than three years from the date of the Order in this proceeding when there is no savings sharing.

Contrary to the assertion of Staff (Resp., p. 3), IAWC believes that the correction to Staff Schedule 10.1 that is identified in Footnote 4 should be made. IAWC understands that Staff favors amortization on CIAC and advances, and such amortization is reflected in Columns 7 and 9 of the Late-Filed Exhibit in which the Acquisition Adjustment is adjusted to reflect the recording of CIAC and advances (as stated in the column headings). As Footnote 6 indicates, however, the Acquisition Adjustment reflected for Column 5 does not reflect the recording of CIAC and advances. (As Footnote 11 shows, the Acquisition Adjustment is properly calculated in Columns 7 and 9.) For this reason, it is not appropriate to show an amortization of CIAC and

advances in that Column. If Staff disagrees with this point, it can, of course, explain its position in Response to the Exhibit.

With respect to Late-Filed Exhibit 2, Staff again indicates that Phase I and Phase II are not defined. Staff, however, received workpapers which show precisely how the data for these periods were developed. On Late-Filed Exhibit 2, the period "Prior to Phase I" is the period prior to filing of a rate case. The Exhibit assumes that this period would be one year, and that all Savings would be retained by the Company during that year. As on Late-Filed Exhibit 1, Phase I on Late-Filed Exhibit 2 is the period when 50/50 savings sharing would be utilized in rate cases in accordance with the Proposed Order. The workpapers show that 50/50 sharing is assumed to be in place during Years 2, 3 and 4, with the final rate order establishing sharing issued during Year 3. No savings sharing is assumed for Phase II, which is the period after Year 4. Because these assumptions are made clear in the workpapers provided to Staff (and could have been further clarified if Staff had returned Mr. Stafford's telephone call), Staff's assertion that the assumptions are unknown is incorrect.

IIRC asserts (Resp., p. 3) that Late-Filed Exhibit 1 is incorrect because it does not "reflect that savings will grow at the rate of inflation." IIRC is correct in observing that, for simplicity, Mr. Stafford utilized the level of Savings reflected for Year 1 of IAWC Exhibit 3.1R, and did not utilize an inflation factor. If, however, IIRC believes that more Savings should be assumed, the solution is for IIRC to say so in its Response to the Late-Filed Exhibit. This is not a basis to strike Late-Filed Exhibit 1.

IIRC (Resp., p. 3) also states that "[t]he amortization of 1999 advances and CIACs have nothing to do with recovery of the \$66 million Acquisition Adjustment." Actually, this is not quite true. As Late-Filed Exhibit 1 indicates (and IIRC apparently does not dispute), if CIACs

and advances are recorded, the Acquisition Premium calculated in accordance with Account 114's language rises to \$126,956,456 from \$66,615,818. Accordingly, if a Premium of only \$66 million is assumed (as is true in Column 5), there would be no CIACs and advances to amortize. Amortization of CIACs and advances are properly reflected in Columns 7 and 9, in which the larger Premium is amortized.